DOW THEORY LETTERS INC.

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36 Letters per Year — $75 Annually

Registered with the Securities Exchange Commission

September 7, 1973 Letter 574

Aug. 24, DJIA 863.49; PTI 636; A-D ratio -16.47
Aug. 31, DJIA 887.57; PTI 651; A-D ratio -15.45

THE PICTURE: I am starting this report with this UPI news release dated September 3. It is an eye-opener, although readers of these reports have had their eyes opened to this probability all along. Having seized 51% of the assets of the major oil companies in his country, Premier Jalloud announced that Libyan crude oil will be doubled in price and that Libya has had it with fiat (non-convertible) paper dollars. It seems to me more than coincidence that this take-over and announcement has come a few weeks before the September 24 IMF meeting in Nairobi. Is Jalloud giving us a taste of things to come? I think so. He is saying (1) The dollar is continuing to inflate, so we'll double our oil price in order to anticipate a halving of the dollar's value in the years to come. (2) We don't want to trade any more of our real assets (oil) for your printing press funny-money. But if you think we won't trade oil for gold, just try us.

U.S. DOLLARS REJECTED

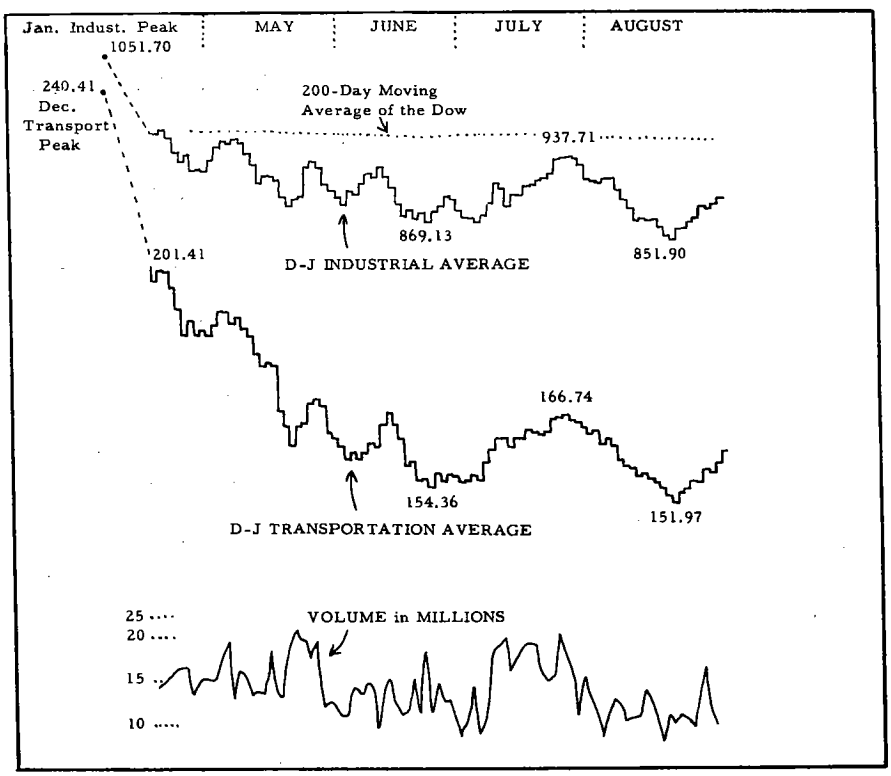
Libya Doubles Crude Oil Price

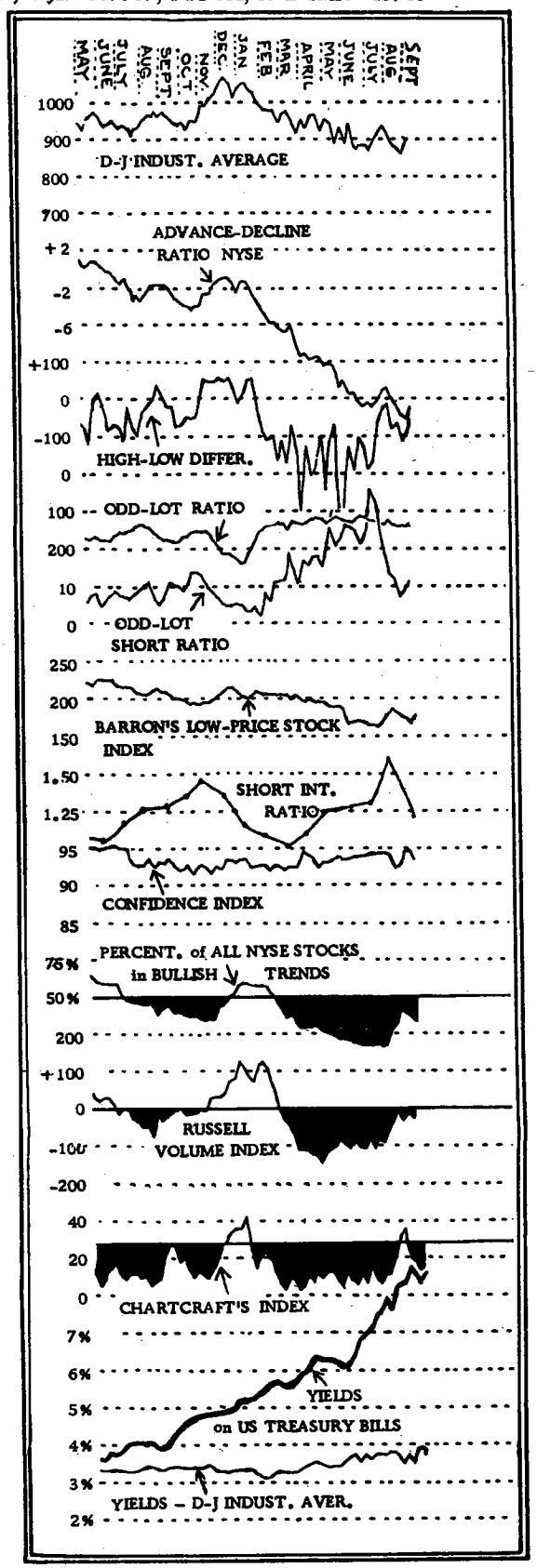
BEIRUT (UPI) — Libyan Premier Abdel Salem Jalloud said yesterday that the price of Libyan crude oil will be almost doubled in the wake of Libya's takeover of controlling interests in all foreign companies operating on its territory. He added that Libya would not accept payments in U.S. dollars.

In a news conference broadcast by Tripoli radio, Jalloud said Libya wanted $6 a barrel for its oil — almost double the current price and more than double the $2.50 paid to Persian Gulf oil producers.

"Libya will no longer accept payment in U.S. dollars," he said. "The dollar has lost its value and we want a currency that is convertible to gold."

The dilemma: The US is coming out of its Disneyland dream. And what does it find? That it can't live like a king unless it possesses the wealth of a king. The US must now either produce like a Germany or a Japan or change its standard of living (downward). The fantastic US "confidence ride" based on the dollar being "as good as gold" is over. The world has lost confidence in the dollar. As far as the US is

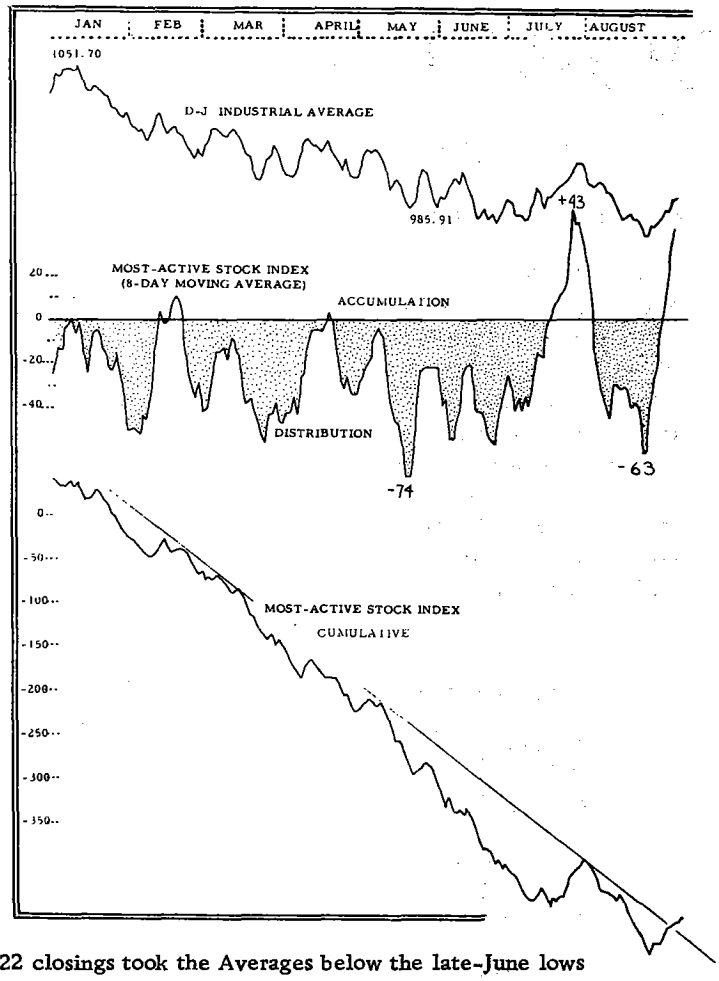




concerned, it's "two and two equals four" time. The rest of the world is telling us that. Premier Jalloud told us that on September 3. He has the oil, and he doesn't need dollars. We are the oil-burners and we're on the spot. And in my opinion, Premier Jalloud may well be "unofficial spokesman" for the Arab world (in which resides two-thirds to three-quarters of the entire oil reserves of the planet earth).

This report has an extra-large section on "Money, Gold, Finance." It's a large section because those issues are looming large, larger than ever. For instance, Henry Kaufman of Salomon Bros. (who knows as much about money as anyone in the country) writes in his August 31 Comments on Credit that the Fed has been sitting in a "holding pattern" for some time now. But "for various reasons," says Kaufman, "it appears likely that the next significant move will be towards more restraint and soon." The main reason for more pressure from the Fed is that the economy won't slow down and become less inflationary. My prediction, it will, it will!

The stock market is now bouncing up from a deep oversold condition, much like a heavyweight boxer who has been knocked down so hard that he literally bounces back on his feet. After all, as I mentioned before, there was only one previous instance in history when the Dow Industrials closed lower six months in a row (a feat which was achieved during January to June, 1973). Six months down in a row calls for a correction, and any rally could be the start of one.



On August 22 (see page 1 chart) the Dow Industrials and Transports touched 1973 lows of 851.90 and 151.97 respectively. The August 22 closings took the Averages below the late-June lows (accompanied by a 13-year low on the Utility Average), yet there was no real downside follow-through. This lack of follow-through is often the sign of a sold-out market, a market which is exhausted from going down.

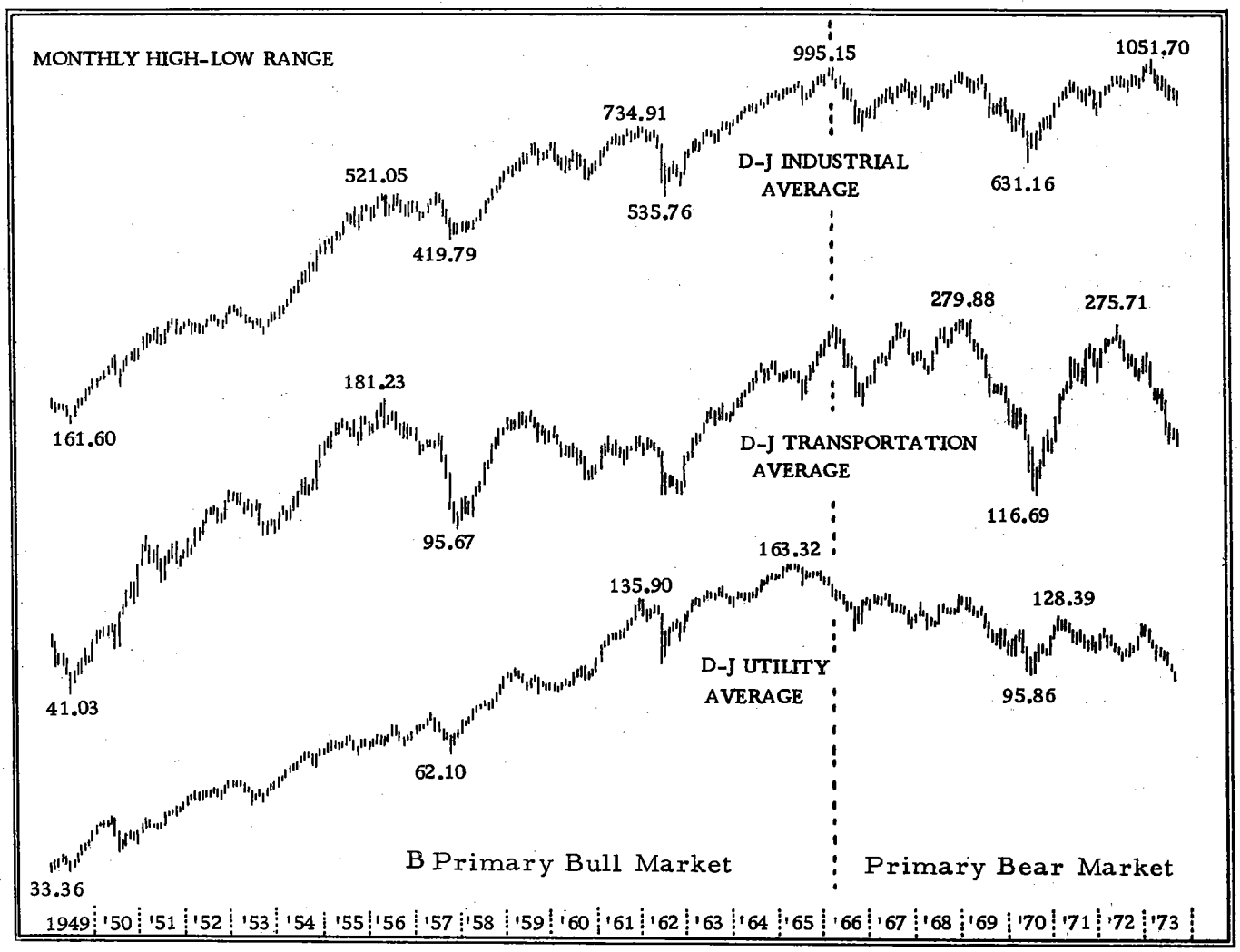
On August 23 a rally began, and as of this writing the rally continues. My own feeling is that the rally is basically technical in nature; it will serve to correct part or all of the January to August collapse in the market. The earlier July attempt at a full corrective rally fizzled out. There is no way of telling whether this one will do any better. I will point to one factor in the current rally's favor, one which was not present in July. (I want to warn, however, that my monetary indicators are not now favorable and "Will Go," our predictive monetary indicator, says "negative" for Wall Street from now to the first week in November — see Letter 571).

The accompanying chart shows the "Most-Active Stock Index" (MAS). This indicator is based on the daily pluralities of advances and declines in the most-active stocks (8-day moving average). MAS has been very helpful in pointing the way for the intermediate term trend. From the minus 63 of August 21, MAS has rallied, turning plus on August 29. This implies upside (most active) leadership activity for the second time in 1973.

In Letter 567 I introduced the CMAS or the Cumulative Most-Active Index. This index is a cumulative running total of the daily most-active totals. CMAS constitutes a check on MAS, and it presents a sort of advance-decline profile of the action in the most-active stocks.

On August 29 CMAS reversed a long, descending trendline which has held in effect all during 1973, suggesting that the intermediate trend in downside action among the most-active stocks is reversing. CMAS is an index which I will be watching most carefully in the period ahead. My feeling is that rallies in bear markets need alot of "plusses" to sustain them. When the plusses peak out, the primary bear trend takes hold again, and the market heads down. Thus, I will be more interested in when CMAS turns down than in the fact that it is now reversing (since the prevailing primary trend is still bearish).

Conclusion: The exhaustion on the downside is giving way to a rally in the market. The extent and duration of the rally obviously cannot be predetermined. So far, this bear market's entire second phase has been unbelievably deceptive — and costly. I expect that situation to continue. Be guided accordingly.



BULL & BEAR MARKETS: In the last Letter I presented a study of the Advance-Decline Ratio going back to 1919. I attempted to place the entire long-term breadth study into meaningful context. It was an analysis which I feel is valid (but one which I have never seen presented in print before). I believe that this kind of long-term study can prove valuable for readers, since it provides them with an overall perspective which simply cannot be gained through shorter term charts. Remember, the real fortunes in the stock market have usually been made by those who were tuned in to the great sweep of the future and then acted accordingly.

One of the rarer charts, for some reason, is one showing the movements of the three D-J common stock Averages over any reasonably long period of time, say ten years or more. Even rarer are charts showing the D-J Averages scaled to ratio or semi-logarithmic proportions. I find charts of the three Averages very useful and particularly so when they show ratio-scale movements. Ratio-scale allows all the action to be correctly compared, since such charts deal with percentage of advance or decline (for instance, on ratio scale an advance in Industrials from 400 to 800 will show as the exact vertical distance as an advance of 75 to 150 in Transports or one of 50 to 100 in Utilities, simply because each represents a rise of 100%).

The Dow Theory is built on interpretations of the movements of the Industrial and Transport (formerly the Rail) Averages. Most of the original writing on Dow Theory was done during 1900 to 1929 (by Charles Dow and William Hamilton). During the period of 1932 to 1939 a brilliant market analyst named Robert Rhea added to, and refined, the Dow Theory. None of these men paid any particular attention to the Utility Average, mainly, as Rhea stated, because the Utility Average only came into being in 1929 and therefore did not offer enough history from which to draw valid conclusions.

E. George Schaefer of Indianapolis was, to my knowledge, the first of the Dow Theorists to utilize the Utility Average in his Dow Theory analyses (he started writing in 1948). I feel that Schaefer's use of the Utilities is well taken, and I too like to use the movement of the Utility Average as a long-term "weather vane." It is true that Utilities tend to be greatly affected by prevailing interest rates. It is also true that the Utilities have a history of being excellent barometers of the intentions of investment-grade funds.

Note on the chart that the Utility Average was the leader during the entire primary bull market which started on June 13, 1949 at 161.60 for the Industrial Average. (Those who believe "13" is an unlucky number might ponder that date. Those who know the Fibonacci series might also be aware of this historic date — see Letter 562, page 2). It is a matter of interest that the Utility Average hit its primary low point (or started its bull market) in February, 1948, a full 16 months prior to the birth of the famous 1949 bottom recorded by Industrials and Transports. Again, it was the Utility Average which topped out on April 20, 1965, at 163.32. This level (not seen again on the Utility Average) proved to be a warning (provided 10 months in advance) of the impending end of the 1949-66 primary bull market, which occurred on February 9, 1966.

I have drawn a vertical line at the February 9, 1966 level. On that day the D-J Industrials peaked at 995.15. Transports were 264.82 on February 9, and although both Averages subsequently climbed to higher levels, they did so alone. Under Dow Theory, a movement is taken to end at the point of the last confirmed highs (or lows). It is a point of extreme interest that at no time following February 9, 1966, did Industrials and Transports both better their 1966 peaks.

Thus, we see the picture of an early 1965 top-out for Utilities, a move which served to forecast the orthodox Dow Theory market top of February 9, 1966. In the primary bear market which has followed, two sets of important lows have been recorded (see chart). These were (1) the lows at the termination of the 1966 decline. (2) The low which occurred at the end of the crushing 1969-70 collapse. The 1970 lows have not since been violated.

On August 22, 1973, however, the Utility Average broke its own 1970 bottom, thereby sliding to a 13-year low of 94.55. I stated in the last Letter that I thought the Utilities were leading the way down during 1973, just as this same Utility Average had led the way up all during the primary bull market of 1949 to 1966.

All extended primary bear markets are subject to three psychological phases (these are not price movements). The first phase occurred during 1966, and it represented the smothering of the excitement of the preceding bull market top. The second phase, the one we are now in, is the phase wherein the market discounts deteriorating economic, social and political conditions. Anyone who cares to examine these three would, I believe, concede that since 1966, economic, social and political conditions have deteriorated (this is a polite way of putting it). We should also remember that the second phase is characterized by deceptiveness, and I would hazard that the stock market from 1966 to the present, has been absolutely outstanding for its deceptiveness. Finally, the second phase is usually the longest phase, and this one has been long, very long indeed.

As I stated before, I feel that the Utility Average is pointing the way for the rest of the market. It is saying that in due time, in the market's own good time, the Industrial and Transport Averages will follow the Utilities through the 1970 lows. Remember, Utilities topped out on the upside in April, 1965, ten months ahead of the other two Averages. The lead time of Utilities could be just as long this time — or even longer.

MONEY, GOLD, FINANCE NOTES: "Wildcat Strikes Surprise Germans," headlines the Christian Science Monitor (Aug. 30) in an article which states that the staid German industrial complex is amazed as 50,000 metalworkers go out in illegal strikes against high costs and general inflation. Germany has been the leader in running Europe's anti-inflationary, sky-high interest rates through the roof, thereby putting pressure on the entire world's interest rate structure.

On August 28 Japan raised its discount rate to 7%, highest in 11 years, in an effort to stem galloping inflation. This puts Japan's rate in line with Germany's but behind the US's 7.5%, France's 9.5%, Britain's 11.5%.

Squeeze: Today, a large national brokerage house showed me that their margin fees are now 12% for margin accounts of 0 to $10,000, 11.75% for $10,000 to $20,000, etc. California and many Western states have usury laws which forbid interest charges of over 10%. How's that for a big Western squeeze, with the prime rate at 9.75%? There is currently $6 billion out on NYSE margin. As they say in the comic strips, "Urghhaaa."

In the US we have seen 14 prime rate increases this year, the latest being a boost to a record 9.75%. Significantly, the latest boost was announced from Chase-Manhattan (a Rockefeller bank) which means that the boost has the Administration's "official blessing." Two months ago, Treasury Secretary Shultz was berating the banks for pushing the prime to 8%.

Last week, in the September "Economic Report" published by the National Bank of Chicago, it was asserted that Government pressures to hold down the prime rate have forced interest rates even higher. These pressures, the Bank says, stem from "the White House, the Treasury, the Committee on Interest & Dividends, the Federal Reserve and the Congress." The Bank then puts forth the shocker that a prime rate of more than 11.25% is needed to break the "vicious cycle" of rising interest rates.

Meanwhile, the Fed has been trying to solve a terrible problem. If inflation continues, people will be unhappy. But if another money crunch comes, business will grind to a halt and people will be unhappy. So what to do? It's easy, let interest rates run to the sky, but make money available at sky-high prices. At some points, business will slow down but not stop.

Result: record interest rates, business still roaring, inflation still in the saddle. Next step, try to cut back (but gently) on the money supply. Results — not yet seen. Biggest game in town — guessing whether interest rates have topped out yet (another way of asking whether bonds have hit bottom). Answer to that one — the biggest brains in the nation don't know.

My overseas buddy, Harry Schultz (known to the financial world as "Two Continents-a-Day" Schultz) has come up with a remarkable end of August report (Schultz, Box 1161, Basel 4002, Switzerland). Harry pieces together from his various contacts, a blueprint for what we might see at the end-of-September IMF meeting in Nairobi. Here's a very brief sketch (1) New monetary system in which dollar will still be important but not a reserve currency, (2) World's central banks to hold gold, SDR's, all major currencies as reserves, (3) Gold to be bought and sold by central banks either at free market price or possibly at new official price of perhaps $125-150, (4) Surplus BOP nation's to be penalized, deficit nation's to be rewarded, (5) Dollar to be convertible into gold, but surplus dollar holding nations will be penalized for having all those dollars for conversion and deficit nations won't have dollars with which to buy gold. So this will be a kind of phony, (6) Gold portion of SDR's will be removed, thus downgrading SDR's even more than they are now.

What does it all mean? As Harry says, it is a compromise between the opposing desires of France and the US with the other countries standing by. Alot, says Schultz, depends on how the system is presented to the world, what is emphasized. I agree for the very short term, but this is how I see it overall (and I believe Harry agrees with me). The US basically wants gold (1) de-emphasized, and they have been on this track with the absurd $42.44 "official price." (2) Kicked out of the world monetary system, and they have been propagandizing for this for years. France (speaking for much of Europe) wants gold (1) as the kingpin reserve, (2) as a check on the US's inflationary bent, (3) priced (realistically) high enough so that it can serve the world as reserve behind all paper.

I believe that if the central banks are allowed to buy and sell gold at (1) a reasonably high official price or (2) the free market price, then France will have won and the US will have lost. If that occurs, the only meaningful part of any nation's reserves will be hard currency (convertible into gold) and gold itself. If world inflation continues, the pressure will be upward on official gold or free market gold and the gold portion of any nation's reserves will be the part that counts.

Remember, the inflationary spiral must either destroy all paper money or drive interest rates (the "monetary defense system") through the roof. Ultimately, monetary destruction places irresistable pressure on gold or sets off a deflationary crash. Either way, men turn to the "store of value" which is gold. If the central banks are allowed to trade gold at a new price, it will represent a tremendous victory for the yellow metal. Supply and demand will do the rest. And increasing supply of paper equals increasing demand for gold. It's as simple and relentless as that. Ultimately, the reality of the value of gold will smash all man-made barriers against it.

Thought: Many fair to good quality bonds are now near or into the 9-10% yield band. This is a rate of return which portfolio managers have been trying to (but failing to) get for years.

I have been asked by many people to describe the course which I feel this bear market will take in terms of human problems. All history tells us that the economic cycles, when boiled down to simplest possible terms, equal boom — then depression. The Bible tells us this when it describes "the seven fat years and the seven lean years." We have all been part of the greatest boom in history. Few people realize it, but the early seeds of depression are already upon us. What are the characteristics of depression? (1) Loss of earning power. (2) Change in living standard. (3) Unemployment. (4) Problems which are international in scope, in contrast with mere (localized) recession. (5) Depressions are accompanied by a great deal of voluntary and involuntary liquidation and bankruptcies.

(1) In terms of real value Americans have lost about two-thirds of their assets and a great chunk of their earning power over the past few years. Of course, I am referring to what has happened to our savings and earnings in terms of gold (gold has tripled in price in three years). (2) Living standards are just beginning to change now, as controls, shortages, rationing, all begin to appear. (3) The current problems are international in scope, and they will continue to be so. Liquidation and unemployment have not yet appeared. Thus, what we have now are the early seeds of potential depression, but these seeds are real.

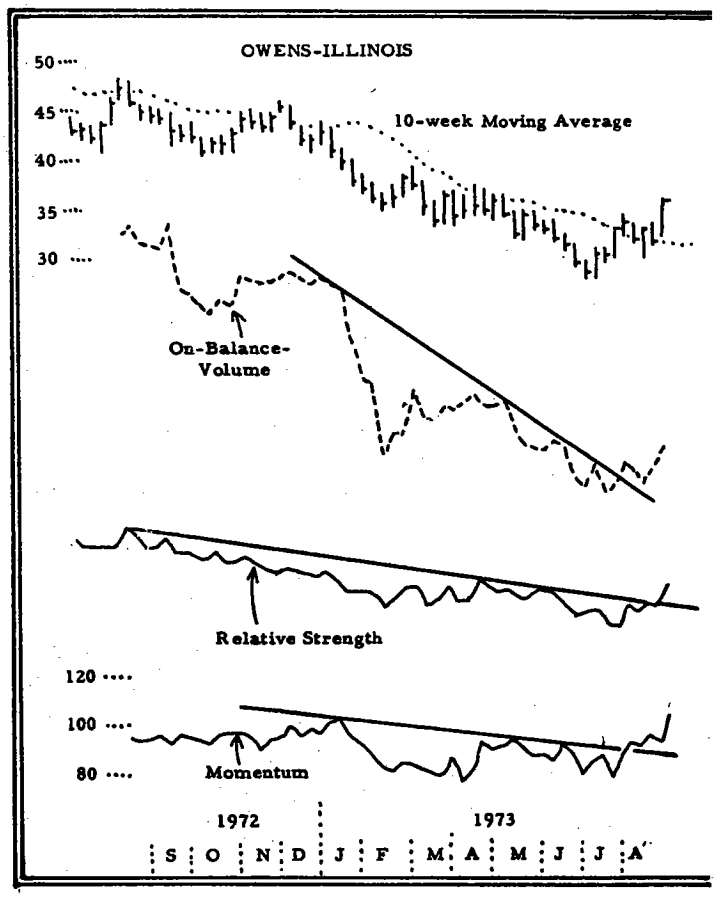
My feeling is that in due time the roaring inflation and the loss of values which inflation is bringing about will give way to real and more classical depression. Inflation hides the disease and pain just as shots of heroin hide from the addict the true state of his own degeneration. But ultimately "2 and 2 equals 4." When that realization takes over, confidence (misguided confidence, I should say) evaporates, and depression arrives.

People ask, what does it all mean? How horrible to think this way. What do we do? My answer is, "We survive." The germs of hope and success are present in every disaster. A man has a heart attack. He immediately stops smoking, he loses 40 pounds, he starts taking long walks, he stops pushing himself, he terminates tense or impossible situations in his life, and lo, he's added twenty years to his ultimate life span. The seemingly disastrous heart attack resulted in a new and better way of thinking and acting. Economic collapse can and should present similar opportunities. Those who see

 this, those who understand this, can help to change the world and make it a better place.

In my opinion, the world has been living on too many lies for too long. The social lies are blowing up, as witness the changing racial front. The political lies are blowing up in Watergate and other places. The economic lies are just beginning to surface. The economy's Watergate is not yet here. It will arrive in due time.

STOCKS: In the Dow Industrial sector, three stocks, Alcoa, Int. Harvester, Int. Paper, carry a strong reading on my charts of 4 (out of a possible 5). One of the Dow stocks is now turning strong with a rating of 3, and I will use it to illustrate. The stock is Owens-Illinois. Note on my weekly chart that following a long decline, the relative strength (RS) line in OI has turned up. This means that OI is starting to act better than the market on a trend basis. RS is computed by taking the ratio of the stock against the S & P 500 Average.



Momentum has also turned up in OI, meaning that OI is now acting better (gauged against its own price movement) on a trend basis. My momemtum index is obtaine by computing the ratio of a stock against its own price 13-weeks ago. When the momentum (MO) line is below 100, it indicates that the stock is acting poorer than its price of 13-weeks ago. The converse is true when the stock is above the 100 level.

Finally, the On-Balance-Volume (OBV) line is computed by adding or subtracting each day's volume in a sort of A-D line of volume. Here again, volume indications are hopeful for OI, but OBV is a bit trickier than RS or MO. The true bullish signals which I look for on OBV are new OBV highs, which precede price. Therefore, I give OI a point for being above its 10-week moving average, one point each for RS and MO, a total of 3 points. (If the short interest was in a rising trend, this would add another point to the total).

GOLD, SILVER, GOLD STOCKS: Having dipped into the low $90's, the price of gold bullion is now holding stubbornly above $100, despite the fantastically high interest rates throughout the world. Remember, every purchase of gold now means that the purchaser prefers the yellow metal to paper which will yield an extraordinary 10% to 12% and even more. Thus, I take the performance of gold (in holding above $100) as a strong one indeed.

The accompanying ratio chart, showing the price of gold and silver, is most interesting, I think, in that it shows percentages of advance or decline. As long as the two metals hold above their rising trendlines, it can be said that their rate of climb is holding steady.

Presently, both metals are holding above their trendlines, but it should be remembered (as I have written before) that gold is a monetary metal used in world monetary reserves whereas silver is not. Silver is a precious commodity. I believe the tumble in the commodity market is now affecting silver, and whereas gold has risen the past three days, silver has declined for three days in a row. This is an unusual performance, and it will be most interesting to follow the two metals on this ratio chart.